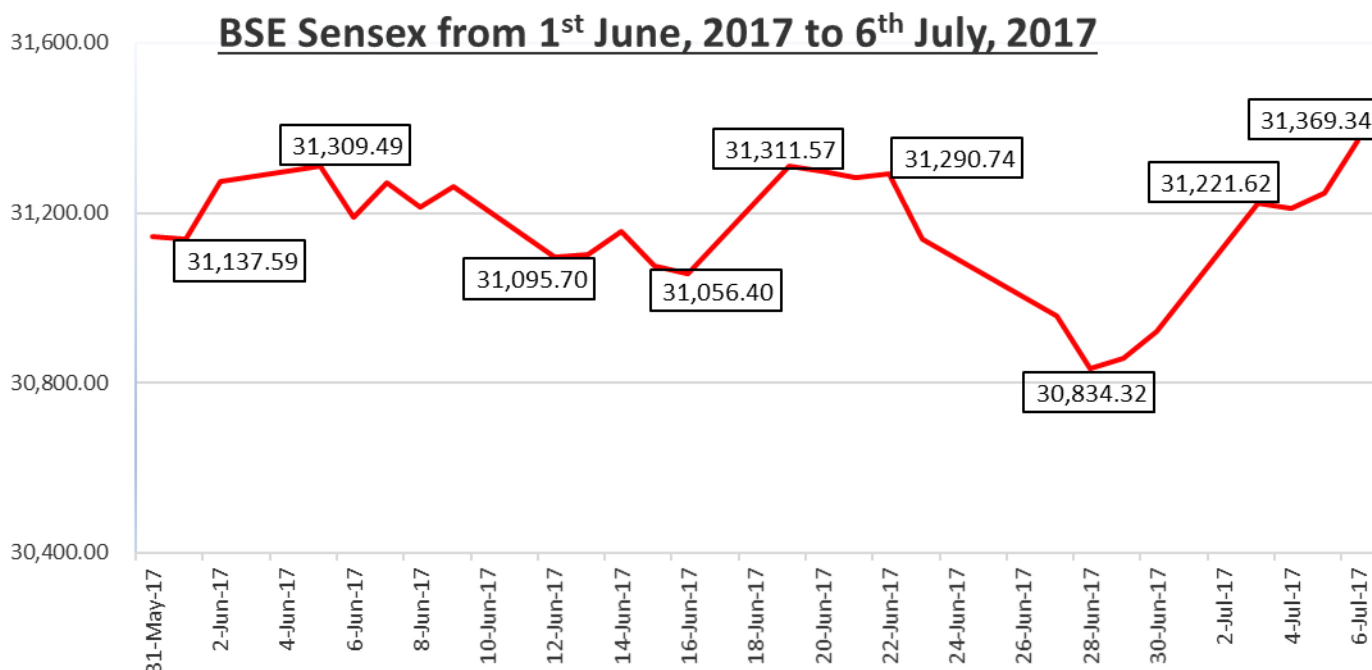
For Private Circulation — *6th July, 2017*

Equities Consolidate in June



Sideways Movement in Stocks

June was a rather dull month for the markets. Sensex, the benchmark index, traded in a narrow range with a net decline of just 0.72 %. At many points of time, there were signs that the market would breakdown and a deeper slide in prices would follow. However, such is the power of liquidity, that at the first whiff of a correction, institutions swooped in and bought stocks. FIIs and FIs competed to buy equities and both were net buyers to the tune of ₹ 3,939.64 and ₹ 6,527.57 respectively. This stance of domestic institutions is not surprising given that as on May end, cash levels at mutual funds were at ₹ 36,300 crores i.e. about 6.46 % of the AUM. With every passing month, mutual funds are growing in size and stature and have now become a mainstream avenue for deploying household savings. The appetite from foreign investors also remains steady as there are no apparent risks to the global economy and that keeps the *risk-on* trade intact.

Investor Fret about High PE Ratios

With these kind of investible surpluses, a question does arise – will price to earnings multiple remain at these elevated levels for an extended period of time? No simple answers except that if interest rates stay at these low levels, and other asset classes such as real estate and bullion continue to be unattractive, then we would have to factor in higher PE ratios into the foreseeable future.

This question does have deep ramifications for

What is the 'Price-Earnings Ratio - P/E Ratio'

The price-earnings ratio (P/E ratio) is the ratio for valuing a company that measures its current share price relative to its per-share earnings. The price-earnings ratio is also sometimes known as the price multiple or the earnings multiple.

The P/E ratio can be calculated as: **Market Value per Share / Earnings per Share.** For example, suppose that a company is currently trading at $43 a share and its earnings over the last 12 months were $1.95 per share. The P/E ratio for the stock could then be calculated as 43/1.95, or 22.05.

Price Earnings to Growth (PEG) at Elevated Levels

investors. A few years ago (may be a decade), a stock was a *'good buy'* if it was available at a PE multiple of about 15 times and underlying growth potential was 15-20 %. This would translate into a PEG (Price Earnings to Growth) of 1 to 1.33 times (15/15 to 20/15). A higher growth stock with good corporate governance and high Return on Equity would be attractive at 1.5 to 2 times its growth trajectory; but that was it. Only a handful stocks traded beyond 2 times PEG.

Stocks with PEG > 3 times	
Company	P/E Ratio
ITC	46.26
ACC	45.58
CRISIL	45.08
ICICI Pru Life	44.77
Dr Lal Pathlabs	42.67
Bharat Forge	42.41
Kajaria Ceramics	42.39
Bosch	41.24
Health.Global	95.74
United Spirits	92.06
BEML Ltd	74.37
Page Industries	73.02
PVR	66.94
Gillette India	64.30
Manpasand Beverages	61.21
Escorts	58.63
Astral Poly	56.34
Thyrocare Tech.	55.83
GRUH Finance	54.09
Marico	51.50
Godrej Consumer	51.43

Currently this PEG ratio has moved up to beyond 2 times for majority of the investment grade listed businesses. There are several growth stocks trading at PEGs beyond 3 times (see table). This puts investors in a quandary. Is this the new normal? Because if it so, then a *'good buy'* should be a stock which is trading at below a PEG of 2. Unfortunately, these are few and far in between.

History has taught us that benchmarks such as PEGs revert to mean and by investing in equities at high multiples invariably results in disappointment. By paying a very high price for a stock, we are discounting the business too far into the future. Even if it is a fabulous business, the trick to successful investing, is buying great businesses at reasonable prices and not at outlandish valuations.

Low Interest Rates Support Higher Multiples

Interest rates do play an important role in discounting of stocks, but India has not witnessed multiyear low interest rates as seen at present; nor has the outlook for inflation and interest rates been so benign and that, perhaps is the reflected in rising valuation ratios. Another aspect to consider is that growth is scarce in India and more so globally. Therefore, any sector or business which displays relatively higher growth rates attracts investors in droves and that pushes PE multiples to stratospheric levels.

Cautious Stance on the Market in the Short Term

To complicate matters in the short term, the upcoming earnings season may be a dampener as companies have cut back production to de-stock the distribution channel. In planning for GST, old stocks, produced and sold under the erstwhile tax regime of excise and VAT, are being cleared to avoid unavailability / confusion of credit for taxes paid. There is also uncertainty surrounding pricing and therefore, businesses are focusing on clearing stocks rather than revving up production. From an investor's perspective, not only do we have to grapple with high PE multiples, but there is the added risk of sub-par financial performance in the near term. This scenario does justify a mild correction either time wise or price wise. We therefore maintain our cautious stance in the near term and seek stock specific opportunities in the June earnings season.

Impact of GST

Long term fundamentals are bright with possibility of good monsoons and pick-up in economic activity post GST related disruptions. In the month of June, the media's focus was on GST and its impact. Our assessment is that GST, if implemented with sincerity and accepted by enterprises of all types and sizes, would have deep impact on the way business is done in India; particularly in the informal sector. We have a large unorganised economy which is not in the tax net. GST will make it very difficult for nefarious businessmen to remain under the scanner of the tax authorities. In order to claim credit for GST, the entity will have to register and generate tax paid invoices. This will increase not only indirect tax collections but direct tax revenues should also get a boost as both are inter-related.

Our large and burgeoning black economy is a bane on the society and has many negative effects. Many economists have identified a deep connection between tax evasion and inequality of wealth and low economic growth. If a tax like GST can make a significant dent on unaccounted transactions then the benefits of this will percolate not only to the economy but also the ethics and value system of our country. We advise investors to have a long-term strategy for equities such that a large portion of their savings are deployed in this performing asset class.

The returns of the portfolios managed by us are as under:

ANNUALISED RETURNS AS ON						30-06-2017	
	1MONTH	3 MONTH	6 MONTHS	1 YEAR	2 YEAR	3 YEAR	5 YEAR
Elixir Equities Portfolio Performance (avg for all clients)	**3.17%**	**5.10%**	**23.72%**	**20.96%**	**14.66%**	**18.57%**	**22.97%**
SENSEX	**-0.76%**	**4.25%**	**17.62%**	**16.23%**	**8.37%**	**8.75%**	**11.64%**
NIFTY	**-1.07%**	**3.70%**	**18.03%**	**16.42%**	**9.25%**	**9.54%**	**12.03%**
Out / Under Performance	**3.93%**	**0.85%**	**5.69%**	**4.54%**	**5.41%**	**9.03%**	**10.94%**

As we wind down our series on Smart Investing, we would like to focus on common mistakes made by investors. This month, we discuss how to avoid purchasing errors so that returns from a good stock idea are optimized.

Dipan Mehta

SMART INVESTING – XXI
- Avoiding Common Buying Mistakes

Selection of Buying Strategy

One of the important building blocks of a performing portfolio is implementing and following a sound system of buying a stock after it has been identified for investment. There are times, when a stock needs to be chased, to be acquired in one's portfolio and sometimes, waiting for the right price may work in favour of the investor. Different scenarios require different strategies and that is where mistakes are made. A stock which has to be purchased immediately may be delayed by the investor as he / she waits for a correction; which remains elusive conversely a stock is bought with a sense of urgency when none is required. *Smart Investing* is assessing the counter better so as to decide on the appropriate buying strategy.

Buying Strategy based on Recent Chart Pattern

The use of charts may help although we don't expect investors to have any knowledge of technical analysis. If the graph of recent price movement is gradually moving upwards, then the investor should complete bulk of his target quantity (50%) within 1-3 trading sessions and seek to average at predefined time interval like every week. If the chart shows a declining trend, then it is better to buy a small portion (about 25 %) and then average lower at every fall. Each subsequent purchase should be of a larger quantity than the previous one such that the weighted average purchase price keeps getting reduced after every buy transaction. A stock with a flat trading pattern (recent) may be purchased at fixed time interval and the quantity executed may be the same for each trade.

These are just thumb rules which investors could follow but if volatility creeps into the stock, then suitable adjustments should be made with a degree of urgency. When acquiring a stock, the *trend is your friend* and following it may reduce the acquisition cost. Any news flow in the company may have an instant impact on the stock price and therefore require a change in strategy. If the news flow is positive, then a more aggressive stance may be optimal. If there is a setback, then purchasing may be suspended as the stock may correct significantly and a re-think on investing in the company may be warranted.

Slicing of Orders

In each of these scenarios, we advocate slicing the purchases over a period of time. One of the principle buying mistakes is that an investor jumps into the stock in one go only to realize that the stock drifts lower after the purchase. There is the temptation to quickly finish the buying so that one can move on with the next task on hand, but that would be a grave mistake which can be easily avoided with a degree of patience and restraint.

Buying Post an Event / Announcement

Another common mistake which long term investors make is buying prior to a major announcement such as earnings release or a corporate development like M&A. In our experience, in majority of the instances, over the longer run, an investor is better placed buying after the news is out. More often than not such news flow may impact the very decision to buy. The investor may want to reassess his/her decision to invest or even the opposite may be true and there is even more conviction to buy, and the quantum contemplated for investment may be enhanced. For trading around an event, there is a street maxim – '*Buy the rumor and sell the news*'. This works for traders. Long-term investors can use to their advantage by making a more informed decision. Short term events get discounted and longer-term trends may get reinforced post an announcement and reduces the risk in a stock.

Avoiding Fear and Greed Syndrome

Fear and greed are innate in every trade and investors may get engulfed in these emotions and change their outlook on the stock and that could be detrimental. A sharp fall for an inexplicable reason should not shake the confidence of the investor in the stock. On the contrary, if the price has moved well beyond the levels the investment decision was made then it is better to wait and seek opportunities elsewhere or at a later point in time. In conclusion, the investor must keep in mind that the investment is for the long term and while marginal price movements or impact costs should be taken in stride, buying at prices beyond a reasonable margin of safety is unwarranted.

Dipan Mehta